

## ALTERNATIVE FORECASTS

DRI\*WEFA has assigned a 55% probability of occurrence to its June 2001 baseline forecast of the U.S. economy. The major features of this forecast include:

- Real GDP increases 1.7% in 2001, 2.3% in 2002, 3.1% in 2003, and 3.1% in 2004;
- U.S. nonfarm employment rises 0.7% in 2001, 0.7% in 2002, and 1.0% in 2003, and 1.1% in 2004;
- the U.S. civilian unemployment rate jumps to 4.6% this year, rises to 5.3% in 2002, and hovers near 5.4% in 2003 and 2004;
- after peaking at 107.6 in 2000, consumer confidence declines to a nadir of 90.0 in 2003, then rallies to 90.8 by 2004;
- consumer inflation is 3.4% in 2001, then ranges between 2.3% and 2.5% thereafter;
- and the U.S. current account deficit swells to \$453.8 trillion dollars by 2004.

While the baseline scenario represents the most likely path for the national economy over the next few years, uncertainties surrounding several key variables mean other outcomes are also possible. To account for this, DRI\*WEFA prepares alternative forecasts based on different assumptions regarding these key variables. Two of these alternative forecasts, along with their likely impacts on the Idaho economy, are discussed below.

The odds of the U.S. economy entering a recession remain high. Both of the alternative scenarios prepared by DRI\*WEFA include recessions. The *Late Recession Scenario* has been assigned a 10% probability of occurrence. The aptly titled *Pessimistic Scenario* has been given a 35% probability of occurrence. This implies a combined probability of 45%. Put another way, the odds are about even the U.S. economy will experience a recession over the next few years.

### LATE RECESSION SCENARIO

DRI\*WEFA's *Late Recession Scenario* has been assigned a 10% probability of occurrence. Unlike the baseline scenario's assumption of benign inflation, inflationary pressures initiate a domino effect that culminates with a recession. First, weak investment slows productivity growth, which puts upward pressure on unit labor costs. Foreign investors, burned by the New Economy meltdown, sour on the U.S. economy, causing the dollar to weaken. While this improves export prospects, it also raises import prices, further fueling inflation. Higher prices from foreign competitors allow domestic companies to raise their prices also. This scenario also assumes market imbalances cause the price of oil to rise to \$35 per barrel.

Climbing prices cause the Federal Reserve to renew its inflation fighting zeal. By the spring of 2003, the federal funds rate is at 6.5%. The higher interest rates cause the housing market to collapse and business investment to decline. The stock market, already sliding because of the departure of foreign investors and the slowing growth in potential GDP, tumbles. Higher interest rates strengthen the dollar, which hurts exports. The economy slides into recession during the summer of 2003. Real GDP drops 2.0% over the subsequent three quarters. The Federal Reserve quickly reverses course once the recession begins, and the economy recovers quickly.

**IDAHO ECONOMIC FORECAST**  
**BASELINE AND ALTERNATIVE FORECASTS**  
**JULY 2001**

	BASELINE				LATE RECESSION				PESSIMISTIC			
	2001	2002	2003	2004	2001	2002	2003	2004	2001	2002	2003	2004
<b>GDP (BILLIONS)</b>												
Current \$	10,386	10,898	11,512	12,142	10,385	10,915	11,450	11,785	10,227	10,562	11,310	11,986
% Ch	4.2%	4.9%	5.6%	5.5%	4.2%	5.1%	4.9%	2.9%	2.6%	3.3%	7.1%	6.0%
1996 Chain-Weighted	9,477	9,697	9,998	10,311	9,484	9,722	9,913	9,967	9,337	9,442	9,913	10,298
% Ch	1.7%	2.3%	3.1%	3.1%	1.8%	2.5%	2.0%	0.5%	0.2%	1.1%	5.0%	3.9%
<b>PERSONAL INCOME - CURR \$</b>												
Idaho (Millions)	32,610	34,222	36,384	38,618	32,611	34,185	36,275	37,636	32,406	33,500	35,773	38,075
% Ch	4.2%	4.9%	6.3%	6.1%	4.2%	4.8%	6.1%	3.8%	3.6%	3.4%	6.8%	6.4%
U.S. (Billions)	8,677	9,074	9,582	10,099	8,679	9,095	9,631	9,902	8,603	8,822	9,389	9,953
% Ch	4.8%	4.6%	5.6%	5.4%	4.8%	4.8%	5.9%	2.8%	3.9%	2.5%	6.4%	6.0%
<b>PERSONAL INCOME - 1996 \$</b>												
Idaho (Millions)	29,665	30,483	31,693	32,920	29,653	30,203	31,129	31,672	29,480	29,932	31,386	32,799
% Ch	1.8%	2.8%	4.0%	3.9%	1.8%	1.9%	3.1%	1.7%	1.2%	1.5%	4.9%	4.5%
U.S. (Billions)	7,893	8,083	8,347	8,609	7,892	8,036	8,265	8,333	7,827	7,883	8,238	8,574
% Ch	2.3%	2.4%	3.3%	3.1%	2.3%	1.8%	2.8%	0.8%	1.5%	0.7%	4.5%	4.1%
<b>TOTAL NONFARM EMPLOYMENT</b>												
Idaho (Thousands)	568.0	575.9	588.4	602.9	568.1	574.7	582.6	585.9	565.9	568.0	583.4	601.7
% Ch	1.6%	1.4%	2.2%	2.5%	1.6%	1.2%	1.4%	0.6%	1.2%	0.4%	2.7%	3.1%
U.S. (Millions)	132.7	133.6	134.9	136.4	132.7	134.0	135.1	134.0	131.8	130.9	133.6	136.2
% Ch	0.7%	0.7%	1.0%	1.1%	0.7%	1.0%	0.8%	-0.8%	0.0%	-0.6%	2.0%	2.0%
<b>GOODS PRODUCING SECTOR</b>												
Idaho (Thousands)	116.1	116.6	118.4	120.7	116.2	117.2	117.6	115.6	114.7	113.6	118.0	121.8
% Ch	0.0%	0.5%	1.5%	2.0%	0.1%	0.9%	0.3%	-1.8%	-1.2%	-0.9%	3.9%	3.2%
U.S. (Millions)	25.2	24.6	24.5	24.5	25.2	24.8	24.7	23.6	24.8	23.5	23.9	24.5
% Ch	-2.0%	-2.5%	-0.3%	0.1%	-1.9%	-1.6%	-0.6%	-4.3%	-3.5%	-5.3%	1.6%	2.7%
<b>SERVICE PRODUCING SECTOR</b>												
Idaho (Thousands)	452.0	459.3	470.0	482.1	451.9	457.5	465.0	470.4	451.2	454.4	465.4	479.9
% Ch	2.0%	1.6%	2.3%	2.6%	2.0%	1.2%	1.6%	1.2%	1.8%	0.7%	2.5%	3.2%
U.S. (Millions)	107.5	109.0	110.4	111.9	107.5	109.2	110.4	110.4	106.9	107.4	109.6	111.7
% Ch	1.4%	1.4%	1.3%	1.4%	1.4%	1.6%	1.1%	0.0%	0.8%	0.4%	2.1%	1.8%
<b>SELECTED INTEREST RATES</b>												
Federal Funds	4.3%	3.6%	4.2%	4.7%	4.3%	3.8%	6.0%	4.0%	4.1%	3.2%	4.2%	4.7%
Bank Prime	7.3%	6.6%	7.2%	7.7%	7.3%	6.8%	9.0%	7.0%	7.1%	6.2%	7.2%	7.7%
Existing Home Mortgage	7.5%	7.7%	7.7%	7.8%	7.5%	7.9%	9.1%	7.7%	7.5%	7.6%	7.8%	7.9%
<b>INFLATION</b>												
GDP Price Deflator	2.4%	2.5%	2.5%	2.3%	2.3%	2.5%	2.9%	2.4%	2.4%	2.1%	2.0%	2.0%
Personal Cons Deflator	2.4%	2.1%	2.3%	2.2%	2.4%	2.9%	3.0%	2.0%	2.4%	1.8%	1.8%	1.8%
Consumer Price Index	3.4%	2.5%	2.4%	2.3%	3.5%	3.3%	3.1%	2.1%	3.4%	2.2%	1.9%	2.0%

**Forecast Begins the FIRST Quarter of 2001**

In this scenario, Idaho's economy initially grows about as fast as its baseline counterpart, but noticeably weakens in the latter years of the forecast. Idaho nonfarm employment advances 1.6% in 2001 and 1.2% in 2002. In the baseline, this same measure rises 1.6% in 2001 and 1.4% in 2002. Idaho real personal income grows 1.8% this year and 1.9% next year, compared to the baseline's 1.8% in 2001 and 2.8% in 2002. In the latter half of the forecast, the weakening U.S. economy takes its toll on the Idaho economy. Both Idaho job and real personal income growth slow significantly compared to their baseline counterparts. As a result, Idaho nonfarm employment is about 16,000 lower in 2004 than in the baseline and real personal income is off by \$1.2 billion.

## **PESSIMISTIC SCENARIO**

The Federal Reserve successfully pulls off a soft landing in the baseline scenario. Both of the alternative scenarios assume the nation's central bank fails to avoid a recession. The major difference between the two is the timing of the recession. In the *Pessimistic Scenario* the recession comes sooner than later. It has been assigned a 35% probability of occurrence. In this scenario, the manufacturing recession infects the rest of the economy. Two reasons for this are excess capacity and inventory problems may be worse than is currently perceived. The situation is particularly difficult for high-tech manufacturers, who are competing with each other and the used-equipment market. In addition, sharp reductions in business investment, a downturn in nonresidential construction, a further slide in consumer confidence, and a sputtering stock market push the economy into a recession.

The Federal Reserve responds to the steady stream of weak second-quarter data by chopping the federal funds rate aggressively to 3.25% by the end of June and to 3.0% in August. However, these efforts to prevent a recession prove futile, as the economy is already in a recession in the second quarter. This recession lasts three quarters, and real GDP shrinks 1.7% over this period. Most of the downturn is caused by investment cutbacks and inventory liquidation. The mildness of the recession hinges primarily on a quick resumption of credit flows, high-but-stable energy prices, and ongoing efforts to exploit the opportunities inherent in the Internet and wireless technologies. Should any of these assumptions not hold up, the downturn could be considerably more severe.

The national recession has a relatively minor impact on the Idaho economy. In this scenario, Idaho nonfarm employment rises 1.2% in 2001. There are about 1,400 fewer goods-producing jobs and about 800 less services-producing jobs in 2001. The personal income measures, both nominal and real, also grow slightly slower than their baseline counterparts in 2001. However, these weaknesses are temporary. The Idaho economy recovers after 2002, and actually makes up some of the ground lost in 2001 and 2002. Idaho nonfarm employment is just 1,200 lower than in the baseline in 2004 and real personal income is down about \$120 million.